MEMORANDUM

TO: Senator Derek Kilmer

FROM: Ellen Evans, Deputy Treasurer, Debt Management
Office of the State Treasurer

DATE: January 30, 2012

Dear Senator Kilmer:

Our office has reviewed alternative strategies to restructure the bonds issued to fund the Tacoma Narrows Bridge, which are largely noncallable voter-approved motor vehicle fuel tax general obligation bonds. Even under "best case" results, a partial restructuring would cost from $250-$500 million. All restructuring strategies examined assume the maturities of the refunding bonds could extend beyond existing maturities. However, current statute states that any refunding bonds issued may not have final maturities that extend beyond the original bonds that they are refunding when the bonds to be refunded are voter approved general obligation bonds. Accordingly, the noncallable TNB bonds cannot be restructured under current statute.

Restructuring Strategies

Our office has recently reviewed options for restructuring the bonds issued to finance the Tacoma Narrows Bridge. The state borrowed approximately $680 million in ten series of bonds issued from 2002 to 2007. At the end of FY 2011, approximately $590 million was still outstanding. More than 90% of the bonds issued for this project were noncallable, i.e. they were structured and sold without call options which enable the state to reduce interest costs by refunding when interest rates decline.

Options for restructuring noncallable bonds include a "tender" and a "defeasance". Neither approach would produce debt service savings for the state. In fact, both would be quite costly. Moreover, both restructuring strategies assume that the new bonds have longer maturities than the existing debt.

A tender involves issuing new tax-exempt debt and using proceeds of the new bonds to buy a portion of the outstanding bonds back from investors. A tender is complicated by the lack of a publically available database showing which individuals, mutual funds, insurance companies or other money managers currently hold the state's bonds. Consequently, tenders are cumbersome and uncommon. In recent years, issuers have been successful in buying back between 25 to 40% of a given bond series. Our analysis assumes investors are paid the current market value of the securities they sell back in the tender plus a premium of 0.25%.

The second alternative, a defeasance, consists of issuing new taxable debt and using the proceeds to buy a portfolio of U.S. Treasuries that produces income sufficient to cover the debt service on the

outstanding TNB bonds. The outstanding TNB bonds would then in effect be repaid from income on the defeasance portfolio. While simpler to execute, this strategy is even more expensive. Low interest rates means that a relatively large portfolio of U.S. Treasuries would be needed to repay the TNB bonds.

To illustrate both strategies, we have selected a scenario which only partially adjusts the TNB debt service: FY 2013 debt service on the TNB bonds is reduced to approximately $40 million in 2013, annual debt service increases annually by 6.5% through FY 2022 and annual debt service levels off thereafter. Financial advisors to the Office of the State Treasurer (Montague DeRose) have modeled the following scenarios (see attached chart):

> Tax Exempt Tender (2038): OST issues tax-exempt current interest refunding bonds with a final maturity in 2038. For the next ten years, annual debt service increases by 6.5% and levels off at $70MM.
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> Tax Exempt Tender (2042): OST issues tax-exempt current interest refunding bonds with a final maturity in 2042. For the next nine years, annual debt service increases by 6.5% and levels off at $64MM thereafter.
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> CABs Tax Exempt Tender (2037): OST issues tax-exempt Capital Appreciation refunding bonds (CABs) with a final maturity in 2037. Annual debt service increases by 6.5% in the next ten years and levels off once it reaches $70MM. (This scenario is theoretical at best; there may not be a robust market for zero-coupon refunding bonds.)
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> Taxable Refunding (2041): OST issues taxable current interest refunding bonds with a final maturity in 2041. Annual debt service increases by 6.5% in the next ten years and levels off once it reaches $70MM.

This analysis estimates that the costs on these four strategies ranges from $250 to $550 million, or from $38 to $137 million on a net present value basis. In our opinion, these costs are "best case" results.

Statute restricts the maturities of refundings of voter-approved general obligation bonds

Current statute states that any refunding bonds issued may not have final maturities that extend beyond the original bonds that they are refunding when the bonds to be refunded are voter approved general obligation bonds. The Tacoma Narrows Bridge bonds meet the criteria for this restriction.

Reasoning

RCW 39.53.090, from the Refunding Bond Act, states that, "the various annual maturities of general obligation refunding bonds issued to refund voted general obligation bonds shall not extend over a longer period of time than the bonds to be refunded."
The Tacoma Narrows bonds were all approved to be issued pursuant to RCW 47.10.843 by the State Finance Committee, as described in the State Finance Committee Resolution that authorized each sale for the TNB.

RCW 47.10.843 comes from Chapter 321, Laws of 1998 and Chapter 334, Laws of 2006.

- **Chapter 321, Laws of 1998**: Sections 1-21 and 44-46 of Chapter 321, Laws of 1998 were submitted to the voters as Refendum 49, which was approved by voters in November 1998. Section 19 of Chapter 321 designates that bonds issued under its authority "shall distinctly state that they are a general obligation of the state of Washington" and are first payable from "the proceeds of the state excise taxes on motor vehicle and special fuels". Thus, bonds issued under this authorization are both general obligation and MVFT bonds.
- **Chapter 334, Laws of 2006**: Chapter 334, Laws of 2006 changed some language regarding which agency was authorized to request that bonds be sold. It did not affect the characterization of the bonds.

The TNB bonds authorized by the State Finance Committee are MVFT GO bonds. Because they are authorized in statute by legislation that was approved by voters, they are also voter approved bonds and subject to RCW 39.53.090.

Looking forward

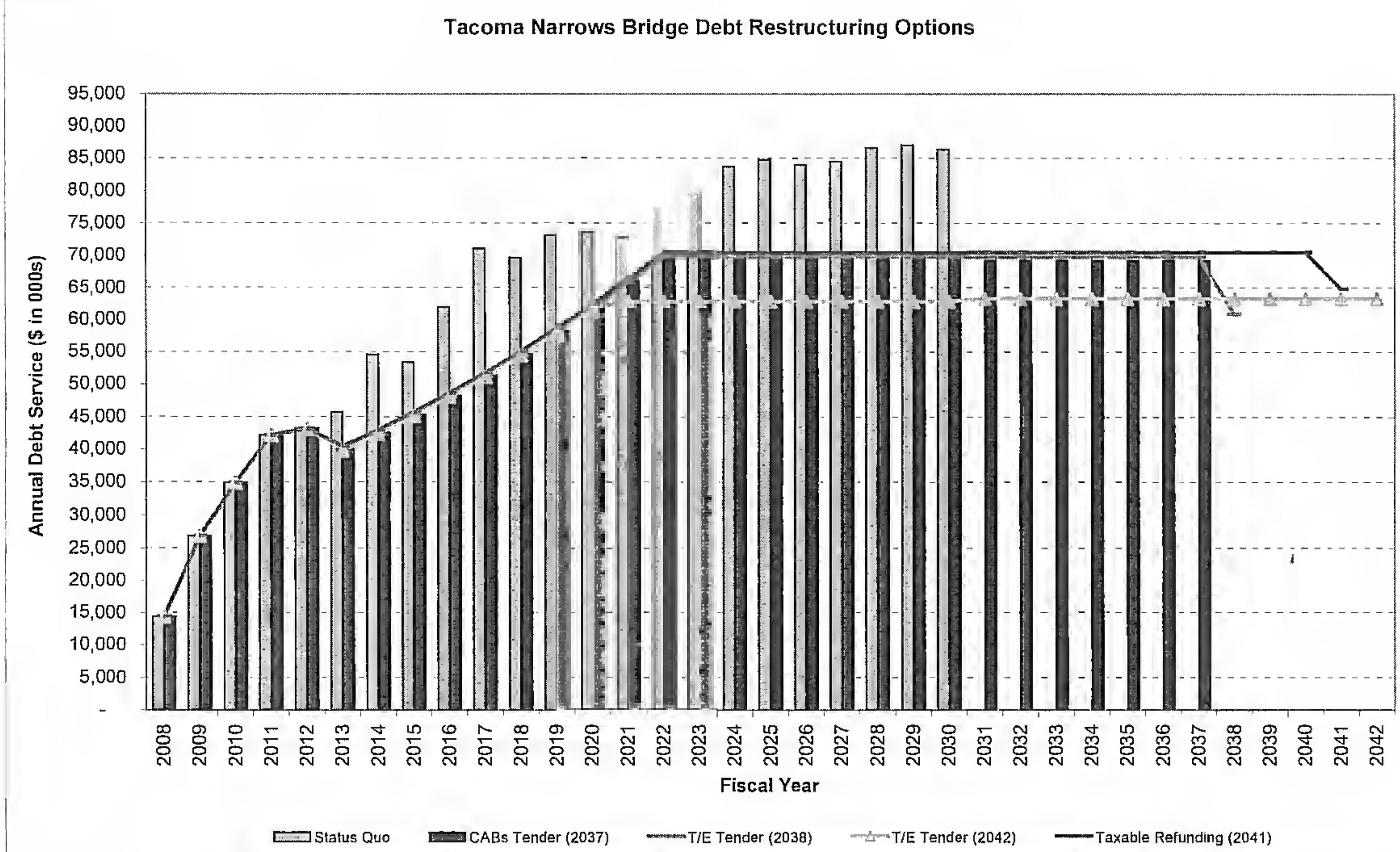
Debt for the SR 520 Corridor Program has been structured within a different framework. Most importantly, debt service on the SR 520 bonds increases only modestly from year to year, in line with projected revenues that assume no toll hikes over time for purposes of repaying the debt. In addition, and consistent with the Treasurer's Principles of Tolling, the bond documents in this financing include a contractual commitment to produce net toll revenues that pay for debt service and meet a specified coverage ratio with a cushion of reserves. All toll backed bonds with maturities beyond ten years are anticipated to be callable.

Sincerely,

Ellen L. Evans
Deputy Treasurer, Debt Management

Enclosure

cc: Clint McCarthy, Senate Committee Services



Financing Option Statistics:

	Total Debt Service	Gross Dissavings	PV Dissavings @ 4.10%	All-In Cost	New Bond Par	Required Fund Deposit	Refunded Par Face Value	New Interest Through 2030
Status Quo	1,491,879,358	-	-	N/A	-	-	-	
Tax-Exempt Tender (2038)	1,806,006,318	(314,126,960)	(59,755,272)	4.10%	445,090,000	504,590,444	644,525,000	409,174,000
Tax-Exempt Tender (2042)	1,950,098,384	(458,219,026)	(83,567,907)	4.19%	560,915,000	631,333,395	816,860,000	515,652,000
CABs TE Tender (2037)	1,742,449,013	(250,569,655)	(37,948,821)	4.46%	182,721,744	181,308,135	234,300,000	-
Taxable Refunding (2041)	2,037,118,368	(545,239,009)	(137,160,993)	4.49%	598,425,000	594,929,323	714,140,000	489,803,000

Assumptions: Restructuring of debt occurs on January 12, 2012 using rates as of the same day. Numbers are preliminary and subject to change.

Montague DeRose and Associates LLC